DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 03-0223
Indiana Corporate Income Tax
For 1998, 1999, 2000

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ISSUE

I. **Applicability of the Throw-Back Rule** – Adjusted Gross Income Tax.

Authority: Public Law 86-272; IC 6-3-2-1(b); IC 6-3-2-2; IC 6-3-2-2(e); IC 6-3-2-2(n); IC 6-3-2-2(n)(1); First Chicago NBD Corp. v. Dept. of State Revenue, 708 N.E.2d 631 (Ind. Tax Ct. 1999); 45 IAC 3.1-1-64; Mich. Comp. Laws § 208.31(3); Jerome R. Hellerstein and Walter Hellerstein, State and Local Taxation: Cases and Materials (7th ed. 2001); Black's Law Dictionary (7th ed. 1999).

Taxpayer argues that the Department of Revenue erred when it required that taxpayer – in calculating its adjusted gross income – add back the income obtained from selling goods to Michigan customers.

STATEMENT OF FACTS

Taxpayer is a holding company for several businesses which sell packaging materials. The Department of Revenue (Department) conducted an audit review of taxpayer's tax returns and business records. The audit found that – in arriving at its adjusted gross income – taxpayer had deducted sales made to Michigan customers by two of taxpayer's businesses. The Department concluded that this specific deduction was unwarranted and that the sales should have been "thrown back" to Indiana. The consequent adjustment resulted in the assessment of additional Indiana corporate income tax.

Taxpayer disagreed with the Department's conclusion and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer explained the basis for the protest. This Letter of Findings results.

DISCUSSION

I. **Applicability of the Throw-Back Rule** – Adjusted Gross Income Tax.

For purposes of calculating taxpayer's adjusted gross income, the money that two of taxpayer's businesses received from selling goods to Michigan customers was "thrown back" to Indiana.

The audit did so on the ground that the two businesses were not subject to Michigan's taxing jurisdiction pursuant to Public Law 86-272.

The basic rule is found at IC 6-3-2-2. IC 6-3-2-2(e) provides that "[s]ales of tangible personal property are in this state if . . . (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and . . . (B) the taxpayer is not taxable in the state of the purchaser." IC 6-3-2-2(n) provides that "[f]or purposes of allocation and apportionment of income . . . a taxpayer is taxable in another state if: (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business or a corporate stock tax; or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." Therefore, in order to properly attribute income to a foreign state, taxpayer must show that one of the taxes listed in IC 6-3-2-2(n)(1) has been levied against him or that the state has the jurisdiction to impose a net income tax regardless of "whether, in fact, the state does or does not." Id.

Taxpayer argues that it is subject to the Michigan Single Business Tax (MSBT) which states that, "[T]he tax levied under this section and imposed is upon the privilege of doing business and not upon income . . . ." Mich. Comp. Laws § 208.31(3). Taxpayer maintains that it has a taxable nexus with Michigan based upon the number of days its sales persons worked in that state. Taxpayer asserts that it did not file the MSBT returns simply as a ploy to eliminate sales to Indiana. According to taxpayer, the MBST falls squarely within IC 6-3-2-2(n) because it is a "franchise tax for the privilege of doing business . . . ." Id.

The Department has interpreted IC 6-3-2-2(n) to mean, "A corporation is 'taxable in another state' under the Act when such state has jurisdiction to subject it to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of Public Law 86-272 . . . ." 45 IAC 3.1-1-64.

Nonetheless, taxpayer maintains that 45 IAC 3.1-1-64 "certainly does not conform to the Indiana statute 6-3-2-2 Section 2n." However, resolution of the question presented by taxpayer does not turn on the finer points of statutory or regulatory interpretation. Under a fair reading of IC 6-3-2-2(n), the issue is whether or not taxpayer's activities within Michigan provided that state with the authority to tax the income received from those activities. Conversely, were taxpayer's activities such that federal law (Public Law 86-272) precluded Michigan from imposing a net income tax on those receipts. Taxpayer chooses to sidestep this standard and focuses entirely on the fact that it paid the MSBT. Taxpayer's rationale is that because it paid the MSBT, it does not have to pay the Indiana tax.

The Department must respectfully disagree with taxpayer's conclusion that imposition of the MSBT automatically precludes Indiana from throwing back taxpayer's Michigan sourced sales receipts. The Indiana Tax Court has stated, "The MSBT is a type of value added tax. VAT" First Chicago NBD Corp. v. Dept. of State Revenue, 708 N.E.2d 631, 632 (Ind. Tax Ct. 1999). "Although taxable income is one portion of the tax base formula, *the MSBT is not measured by or based on income*." Id. at 634 (*Emphasis added*). "The law [Public Law 86-272] applies only

to net income taxes . . . and does not apply to the general business of taxes of states that do not employ a net income measure, such as Michigan's Single Business Tax, which is a form of value-added tax." Jerome R. Hellerstein and Walter Hellerstein, State and Local Taxation: Cases and Materials 389 (7th ed. 2001).

In every sales transaction, at least one state has the power to impose a net income tax on the money derived from the sale of tangible personal property; if the state in which the sale occurred is forbidden to do so by Public Law 86-272, then the income is "thrown-back" to the originating state. In this case, taxpayer sold goods to Michigan customers, but Indiana was the originating state. Michigan is not constrained by Public Law 86-272 from imposing the MSBT because the MSBT is not a net income tax. Therefore, the issue is whether taxpayer's activities within Michigan were such that Michigan has "jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, [Michigan] does or does not." However, taxpayer has declined the opportunity to do so because it" [does] not believe it is necessary to provide any additional information related to Michigan activities." Instead, taxpayer concludes that imposition of the MSBT is entirely dispositive of the question of whether Indiana may throw back these sales; taxpayer errs because the MSBT is not "a *franchise* tax for the privilege of doing business . . . ." IC 6-3-2-2(n). The MSBT is not "based on or measured by income." First Chicago NBD, 708 N.E.2d at 634. (*Emphasis* added). As a VAT, the MSBT is one of the costs of doing business in Michigan; however, the MSBT itself is akin to a sales tax, it is plainly not a tax based on or measured by income.

Based upon the information taxpayer chose to provide, it is not known whether taxpayer's activities within Michigan gave that state the authority to impose a tax based on taxpayer's Michigan income. Based upon the information taxpayer chose to provide, it is not known whether taxpayer's activities within Michigan were such that Public Law 86-272 *precluded* Michigan from imposing a tax based upon on taxpayer's Michigan income. Therefore, the sales proceeds were properly thrown back to Indiana.

FINDING

Taxpayer's protest is respectfully denied.

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